



July 26, 2004

Ms. Susan D. Larsen, Deputy Director, Division of Public Utility Accounting
Mr. David R. Eichenlaub, Assistant Director, Division of Economics and Finance
Mr. Timothy R. Faherty, Manager Consumer Services, Division of Energy Regulation
State Corporation Commission
P.O. Box 1197
Richmond, Virginia 23218-1197

Re: **Ex Parte: In the matter of establishing rules
and regulations pursuant to the Virginia
Electric Utility Restructuring Act for
exemptions to minimum stay requirements
and wires charges
Case No. PUE-2004-00068**

Dear Ms. Larsen, Mr. Eichenlaub and Mr. Faherty,

In response to the State Corporation Commission's Order Establishing Proceeding issued June 16, 2004, Virginia Electric and Power Company (the "Company") provides the attached comments and responses to the questions raised in the Order.

The Company fully supports the initiative to establish a work group to assist the Commission Staff in developing a set of rules for the Commission's consideration. In recent proceedings before the Commission the workgroup process has been successful in identifying significant issues, developing workable solutions and avoiding protracted litigation. Such a work group in this proceeding will provide an opportunity for all stakeholders to have representation and effective input in the development of the rules necessary for the implementation of the new statutory provisions. A collaborative effort to develop the rules will allow the programs specified in the new statutory provisions to develop quickly, adequately address concerns of the stakeholders, and help to promote effective competition in the Commonwealth.

We look forward to working with you in this workgroup process.

Very truly yours,

David F. Koogler
Director, Regulation and Competition

Attachments

**COMMENTS OF VIRGINIA ELECTRIC AND POWER COMPANY
ON THE COMMISSION'S ORDER
ESTABLISHING PROCEEDING
CASE NO. PUE-2004-00068**

INTRODUCTION

Virginia Electric and Power Company ("Dominion Virginia Power" or the "Company") submits these comments and responses pursuant to the Order Establishing Proceeding issued on June 16, 2004 in this docket ("Order"). The Company appreciates this opportunity to work with the Staff and other interested parties in crafting recommendations to implement, in the most effective way, the Minimum Stay and Wires Charge Exemption Programs ("Programs") required by the passage of Senate Bill 651 amending the Virginia Electric Utility Restructuring Act ("the Restructuring Act"). Virginia Code §§ 56-577.E.4 and 56-583.E.4, as adopted in 2004, direct the Commission to promulgate such rules and regulations as may be necessary to implement these Programs. The Company believes that the rules promulgated by the Commission should be generic, in order to allow incumbent utilities to design their individual programs to address appropriately their unique business circumstances and external factors. By mandating policy in broad, general terms, the Restructuring Act provides flexibility in implementation. Therefore, the Company's responses to the questions contained in the Commission's Order focus on the necessary components of implementation of the Programs without being prescriptive in nature.

In the Order, the Commission stated that it will implement the Programs using a two-tiered approach. The first step will involve convening the work group to consider and

discuss implementation of these new provisions of the Restructuring Act and assist the Staff in developing recommended rules and regulations. The second stage will provide public notice of the proposed rules and afford interested parties an opportunity to comment or request a hearing.

The Company fully supports the Commission's intention to use a multi-tiered approach to implementing the Programs. However, the Company suggests a third step in the process: a requirement for incumbent utilities to file specific, individual implementation plans. These plans will comply with the finalized, generic rules and regulations, including those relating to the determination of rates based on market-based cost methodology.

For example, utilities will have different levels and mixes of eligible large industrial, large commercial and aggregated customers. Each utility will also have different levels of MWs available for its Programs. Given its unique circumstances, each utility may choose to approach implementation of these Programs differently. The Commission's rules and regulations for the Wires Charge Exemption Program will need to provide individual utilities the opportunity to develop different approaches to address the allocation of the eligible MWs among the various customer classes, including the first-come, first-served award of available MWs to the different classes of eligible customers.

The Company believes the successful implementation of the Programs will move the Commonwealth toward the Restructuring Act's goal of a fully competitive retail electricity market. In addition to stimulating retail competition, implementation of these Programs will provide stakeholders in the restructuring process with valuable information

about the next steps necessary to advance the development of Virginia's competitive retail electricity supply market, both during the transition period and beyond.

The retail access pilot programs the Company is currently implementing are providing significant insight into such processes as competitive retail bidding and municipal aggregation. The new Programs, and specifically the Wires Charge Exemption Program, will also provide an excellent learning experience. In the Company's service territory alone, the amount of MWs available in the Wires Charge Exemption Program is twice the size of the Company's current retail access pilots. Such size, coupled with the development of broad generic rules, will allow for greater flexibility and result in excellent learning opportunities for all stakeholders.

The Company proposes the rules contained in Attachment A as a starting point for the work group's consideration. These proposed rules are divided into three sections. The first addresses the requirements for the determination of rates using market-based costs as specified in the amendments to the Restructuring Act, the second outlines the requirements of the Minimum Stay Exemption Program, and the third addresses the requirements of the Wires Charge Exemption Program. The proposals fulfill the intentions of the Restructuring Act while recognizing the unique nature of each utility.

RESPONSES TO QUESTIONS

In its June 16, 2004 Order, the Commission sought input and recommendations on eleven enumerated questions raised by the new statutory exemptions created by Senate Bill 651.

Dominion Virginia Power respectfully submits the following comments and recommendations concerning those questions.

(1) What new retail access rules and modifications to existing retail access rules are needed to implement the Minimum Stay and Wires Charge Exemption Programs?

It is important to note the existing retail access rules (20 VAC 5-312-10 *et seq.*) ("Retail Access Rules") should be viewed as "permanent". Conversely, the Programs are "temporary" in nature. Under the Restructuring Act, wires charges will end by June 30, 2007 and, at some point in time (most likely the expiration of capped rates on December 31, 2010) any rules required for the Programs will no longer be needed. The Retail Access Rules, however, still will be applicable.

While parameters are clearly needed for the procedures and processes for these Programs, such temporary measures can be incorporated into the framework of each individual utility's plan. Accordingly, the rules adopted for the Programs should be separate from the Retail Access Rules and, therefore, the Commission does not need to develop new, or modify existing, Retail Access Rules. To the extent that conflicts arise between the existing Retail Access Rules and procedures for these Programs, the Commission may, on a case by case basis, allow exceptions to the rules. The Commission has taken this approach for the Company's recent retail access pilot programs.¹

(2) What verifiable milestone event(s) constitutes "the transfer of the management and control of an incumbent electric utility's transmission assets to a regional transmission entity?"

The date of actual transfer of management and control will coincide with the termination of the Company's Open Access Transmission Tariff ("OATT") and the implementation of the PJM OATT for customers taking transmission service under the Company's OATT. Functional control over the Company's transmission assets will be transferred to PJM pursuant to the PJM South Transmission Owner Agreement. The PJM interchange energy markets, congestion management, financial transmission rights, planning and expansion protocols, and other matters will apply to the region under the PJM Operating Agreement. The PJM South Reliability Assurance Agreement will expand the existing PJM capacity requirements to the region. A prerequisite to such events will be final approvals of the applications to join PJM as PJM South pending before this Commission, the

¹ For example, in the Company's pilot programs, the Commission has allowed for customer assignment in the Competitive Bid Supply and Municipal Opt-out program without the customer's positive affirmation that is normally required by the Retail Access Rules.

North Carolina Utilities Commission, and the Federal Energy Regulatory Commission ("FERC").

- (3) **Do the legislated Minimum Stay and Wires Charge Exemption Programs apply to retail electric cooperatives? Explain why or why not?**

The new provisions of §§ 56-577 and 56-583 do not directly address the applicability to cooperatives.

- (4) **Describe, in reasonable detail, the methodology that should be used to determine "market-based costs." Such description should address each of the three cost components: "(i) actual expenses of procuring such electric energy from the market, (ii) additional administrative and transaction costs associated with procuring such energy, including, but not limited to, costs of transmission line losses, and ancillary services, and (iii) a reasonable margin." Specifically, for each component, identify (1) each cost item that should be considered within that component; (2) how each such cost item should be determined, including the informational source of any data needed in such determination (differentiate between actual and estimated costs and also, to the extent relevant, differentiate between incremental cost and fully allocated cost, including the application of cost overheads); and (3) an explanation of the economic rationale for the determination of a reasonable margin.**

The methodology for determining rates from market-based costs should include a plan for procuring energy and capacity to serve the requirements of electricity supply service for those customers taking advantage of the provisions of Senate Bill 651 related to avoiding the wires charge or the minimum stay requirement. The requirements of these Programs ("Program Requirements") should be known and quantifiable under the Rules Governing Retail Access to Competitive Energy Services in the Commonwealth ("Retail Access Rules") and any requirements of PJM for load-serving entities providing service to retail customers. The load requirements for customers returning to service from the incumbent will most likely not be known until there is a direct requirement for supply of that load. The obligation of the incumbent to serve this load will, most likely, be known and quantifiable only a short period of time prior to delivery to the customer. The utility's plan will provide for procurement of energy and capacity using the best known and quantifiable information at that time. Procurement of energy and capacity for such customers will likely be obtained from the PJM market and/or other accessible regional competitive markets. Obtaining long-term bilateral contracts to serve the Program Requirements is not a reasonable option for utilities, due to the short notice of the need to serve the load, and the short notice

with which such load can return to the competitive market. The use of long-term contracts would result in sunk costs adversely affecting the utility if customers do not return to the market-based cost service. Therefore, such costs cannot be recovered.

Actual expenses for procuring energy and capacity to serve the Program Requirements, as well as the relevant data source, should be determined in the procurement plan filed by the utility. The plan should state that costs for energy and capacity would be the actual cost for procurement from competitive markets in PJM and/or other accessible regional competitive markets. Other transaction costs for providing Program Requirements to be purchased from PJM should include, but are not limited to, FERC-approved transmission service rates and charges, ancillary service rates and charges, and congestion costs. Additional administrative costs - those costs required to make the retail offerings - should include, but are not limited to, direct labor, services and materials needed to develop and administer the program; allocation of common costs (i.e., overhead costs); and applicable income taxes. Retail administrative costs, including fixed costs related to the development and operation of systems to administer the service to provide Program Requirements, will be incurred and need to be recovered.

The amendments to the Restructuring Act also call for the utility to receive a reasonable margin. Unlike margins allowed utilities under traditional rate making, this reasonable margin will not be a function of capital investment and the cost of capital. Instead, determination of a "reasonable margin" for a utility in connection with market-cost pricing for the Programs will be determined similarly to the net profit margins in a service sector business. The reasonable margin is appropriate, as it will serve to advance retail competition in the Commonwealth. Including a reasonable margin in the charge to customers recognizes that competitive service providers ("CSPs") making offers to customers will require that the market-based pricing include a margin above the utility's costs to stimulate CSP participation in the competitive market. If the charges from the utility did not include a fair and reasonable margin, then customers may have a price advantage by returning to the utility. Such a situation would not advance retail competition in the Commonwealth and would not be desirable for these Programs.

(5) How will the Commission be assured that:

- a. an incumbent utility purchases electric energy from the market without adversely affecting itself or retail customers?**

The costs of capacity and energy procured from the market for these Programs will be passed solely and directly to participants through rates based upon the utility's market-based costs described in the response to

Question 4. Non-participants, including those under capped rate service, will not be affected.

- b. **an incumbent utility purchases electric energy to assure minimum cost for such energy?**

Customers participating in the Programs will, as noted in the response to Question 4 above, be subject to paying for Program Requirements, procured from competitive markets in PJM and/or other accessible regional competitive markets. Since Program Requirements will not be most accurately known and quantifiable until the day before they are needed, the utility's plan should seek to procure such capacity and energy from competitive markets where the cost is minimized for the customers requiring this service. That cost may be based upon the procurement from the PJM spot market (Day-ahead and Real-time market) and the Daily Capacity Credit Market or could be from another competitive market in the region that is accessible to the utility.

This pricing, however, should not be more favorable than the options provided by CSPs. This pricing mechanism should be similar to rates determined from the market-based costs offered in many retail access jurisdictions. These rates are considered a "safety net" service available as a short-term option for customers who have previously gone to the market, but for various reasons need to return temporarily to the security of a service provided at prices set by a Commission-approved market-based pricing methodology. This service will provide assurance that electricity supply is available at reasonable and equitable pricing to customers for a short period of time. As stated in the response to Question 4, obtaining long-term bilateral contracts to serve Program Requirements is not a reasonable option for utilities nor will it serve to advance retail competition.

- c. **an incumbent utility uses appropriate hedging techniques in the purchase of electric energy? Should the cost of any hedging techniques be included among the "actual expenses" of electric energy?**

Since procurement of Program Requirements may be made from the PJM spot market (Day-ahead and Real-time markets) and the Daily Capacity Credit Market or from other competitive markets in the region that are accessible to the utility, hedging against volatility in prices will not be undertaken. The utility may hedge against transmission congestion using the Fixed Transmission Rights/Auction Revenue Rights that may accompany the customer load when it returns to the utility. The benefits or

costs of such hedging should be included among the actual expenses of electric energy.

- (6) **Given the requirement that the methodology to determine "market-based costs" must be consistent with the goal of promoting economic development within the Commonwealth, as well as promoting effective competition, should issues associated with the level and stability of rates and prices reflecting "market-based costs" be considered? If so, how?**

During the transition to a competitive retail market, the Minimum Stay Exemption Program will provide the opportunity for customers to move more freely in and out of the competitive market and for CSPs to make offers in the Wires Charge Exemption Program. In addition, price stability and continuity of a pricing offer should and will be provided by CSPs to customers.

As noted above, pricing for this "safety net" service that these Programs offer should be reasonable and not punitive. However, the rates based on market costs for these Programs should be appropriately priced to reflect the overall short-term market in situations where supply must be procured on a daily basis to meet the needs of customers who return with little notice. By its nature, service procured under these circumstances is subject to fluctuations in the market and should not be considered a long-term solution by customers. Such long-term solutions should be offered by CSPs. Implementation of this "safety net" service does not necessarily require that all pricing should be done on an hourly interval basis, but pricing should be of a short enough duration to reflect any changes in the market. This service should not be designed as a stable, long-term pricing option. To do otherwise would effectively position this market-based "safety net" service as a competitor with those services offered by CSPs. The Company believes that such action conflicts with the Restructuring Act's intent to promote effective competition in the Commonwealth.

Successful development of a retail competitive market will also encourage economic development within the Commonwealth as CSPs will be able to provide pricing options to customers that best serve the customer needs. Further, the expectation is that larger industrial and small commercial customers will want to locate in an area where retail choice markets are more fully developed. The experience in other states where retail choice has developed, as well as the intense interest by commercial customers in the Company's own Retail Access Pilots, confirms this expectation.

- (7) **Should the ultimate methodology to determine "market-based costs" be permitted to vary among incumbent utilities? Explain why or why not.**

Yes. The Company believes that each utility should be able to design and present its own methodology as long as it complies with certain principles defined in the

Commission's rules. The Company believes the high-level market pricing rules shown in Attachment A are the only elements that need to be in common between utility plans. Ultimately, beyond the basic principles, reasonable differences may exist among utilities as long as the methodologies for identifying and quantifying the market-based costs and other costs to be recovered (e.g., transmission, ancillary services, administrative costs) and a profit margin conform to the statutory requirements. Further, different approaches among utilities will also allow for the testing of market-based pricing concepts that will be applicable after the expiration of capped rates.

(8) Interpret the extent of the legislated jurisdiction provided to the Commission with respect to the determination of "market-based costs," for example:

a. Is the Commission's jurisdiction strictly limited to determination and approval of a methodology?

The Commission will approve a formula for the specific rates to be determined and will then oversee its implementation to retail customers under its jurisdiction.

b. How frequently may and should the Commission review and/or modify the approved methodology?

The Restructuring Act does not mandate review or modification by the Commission of the pricing methodology. The initial 18-month time period for the Wires Charge Exemption Program will allow for the Programs to develop and the Commission and utilities to gather information and data. After this initial period, review and modification of the methodology may be appropriate for implementation of the next phase of the Programs.

c. Does the Commission's jurisdiction extend to oversight of the actual determination of "market-based costs," including the audit, calculation, and billing of such costs and dispute resolution?

The Commission should be able to ensure that the methodology is properly applied to retail customers under its jurisdiction.

(9) Given the Wires Charge Exemption Program requirement for 60 days' prior notice to the incumbent utility for the return to service and purchase of retail electric energy at "market-based costs," who, if anyone, is obligated to serve a participating customer for those 60 days, and at what price, if such

customer's competitive service provider defaults and there are no competitive options available to the customer?

In the event of default by a CSP, the obligation to serve should be the responsibility of the incumbent utility. The Retail Access Rules require that a CSP provide 30 days notice of termination to individual customers and 60 days notice for terminating service to a customer class or abandoning service within the Commonwealth.

The Rules do not dictate the pricing that will be applicable to customers returned to the incumbent in a shorter time period in either instance. Each incumbent utility's specific plan should address the pricing available to customers who are returning without 60-days notice in the Wires Charge Exemption Program.

(10) What demand threshold should be established for aggregated customer participation in the Wires Charge Exemption Program? Explain why.

Each incumbent utility should address this issue in its company-specific plan. As it designs its plan for submission to the Commission, the Company will work with constituency groups, CSPs and other stakeholders to establish minimum demand criteria for participation through aggregation.

The Company intends to establish a threshold as low as possible to encourage participation by residential and small business customers. The Company would like to see a variety of diverse aggregation groups participate.

(11) Subsequent to the eighteen-month demand limitation on participation in the Wires Charge Exemption Program, should such limitations be completely eliminated? Explain why or why not?

The Company believes that it is premature to address this issue at the outset of development of the Programs. A more realistic determination can be made once successful implementation takes place and information is gathered on the Programs' progress.

In conclusion, the Company appreciates the opportunity to submit these responses. The Company looks forward to participating in the work group to assist the Staff in recommending the necessary components of market-cost methodology, as well as the proposed rules and regulations to implement the minimum stay and Wires Charge

Exemption Programs pursuant to §§ 56-577 and 56-583 of the Act. Development of generic rules for the implementation of these Programs will provide the flexibility for each utility to design plans that will allow the stakeholders to gain invaluable experience in the development of the competitive retail market.

Service Plan for Returning Customers:

Rates based on the cost of the market will be determined for customers that have elected to avoid the minimum stay requirements or the utility's wires charges and return to service from the incumbent utility. The utility will submit a plan to determine rates based on the following:

- A plan for procurement of electric energy from the market that includes purchase of energy and capacity supply, FERC-approved transmission and ancillary services rates and charges, identification of the specific costs of procurement, and the method to account for such costs
- Identification of incremental administrative costs for procurement of energy, capacity, transmission and ancillary services
- Allocation of common costs that support the program administration
- Determination of other transactional costs
- Determination of a reasonable margin
- Inclusion of the effects of any applicable income taxes
- Establishment of pricing schedules and a plan for each class of customers for recovery of market-based costs
- Establishment of market-based cost mechanisms that will remain fixed for the initial 18-month term of the program

Minimum Stay Exemption Program:

In the development of its Minimum Stay Exemption Program an incumbent utility shall provide a plan for customers requesting an exemption of the minimum stay requirement. Such plan shall include:

- Rates based on the cost of the market pricing information applicable to the customer requesting such exemption
- Notification of capped rates available to the customer if the customer does not choose to be exempt from the minimum stay requirement
- An explanation of how the customer may return to capped rates

Wires Charge Exemption Program:

In the development of its Wires Charge Exemption Program, each utility shall provide a plan that includes:

- Explanation of rates determined by the market-based costs applicable to the customer upon return to the incumbent utility
- Procedures for customers exercising both 60-day notification requirements
- The method whereby a customer may cancel participation in the program prior to enrollment
- Development of a process for the implementation of "first-come, first-served" and its attendant waiting list
- Determination of total load available for the program and an allocation plan, consistent with other provisions of the Restructuring Act, for distribution of the MWs to the various classes of customers

- **Development of procedures and options for provider of last resort service for customers abandoned by their suppliers**